Are Slotting Allowances Anticompetitive?

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Over a decade ago slotting allowances became a controversial innovation to the grocery business. In an earlier paper, I argued that slotting allowances have important procompetitive effects. First of all, they serve as an incentive signal, allowing manufacturers to "put their money where their mouth is." Second, they allow the risks of the innovation process to be allocated between retailers and manufacturers. I further analyzed claims that slotting allowances are anticompetitive, and found that they had significant flaws.

This paper looks at subsequent industry developments, legal cases, congressional testimony, as well as scholarly articles, to again ask whether or not slotting allowances are anticompetitive, and what should be the appropriate legal policy towards the practice.

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Introduction

Slotting allowances are one time payments made by manufacturers to retailers at the time of product introduction to reimburse retailers for the costs they incur when they adopt new products. They were relatively unknown before the latter half of the 1980s, but have since become commonplace in the grocery industry. They have begun to show up in other industries as well, such as pharmaceuticals, hardware, and computer software.

Ten years ago I published an article in this journal on the proper antitrust treatment of grocery slotting allowances. [Kelly 1991] This practice was then, and remains today, a controversial topic. In my earlier article, I noted that innovation in the grocery industry was a risky process. I suggested that slotting allowances could serve as an incentive signal that could transmit valuable information from manufacturers to retailers. I also suggested that slotting allowances were a way for manufacturers and retailers to allocate the risks inherent in the innovation process. Finally, I noted that slotting allowances could serve to allocate shelf space within a supermarket, giving retailers messages about which products need to be

I went on to examine several hypotheses that slotting allowances were anticompetitive. I argued that while these hypotheses could not be ruled out, they did have a number of problems. I concluded that while it was not possible to give a definite answer as to whether or not slotting allowances were anticompetitive, there was strong reason to believe that the practice was a natural marketplace response to increased innovation. Antitrust enforcement against the practice therefore runs the risk of discouraging procompetitive conduct.

Over the past decade, several things have happened. The marketplace has continued to change. Other scholars and commentators have looked at this phenomenon. There have been several cases on this topic. Given these changes, it is appropriate to take a second look at how the antitrust laws should treat slotting allowances.

The Procompetitive Case

A consequence of the unfriendly takeovers of the 1980s was to pressure corporate managers, including those of grocery manufacturers, to increase returns to their shareholders. This in turn produced a growth in the number of new product introductions.

There is a limit as to how many items a single supermarket can carry. By the late 1980s grocers found that in order to bring in a new item, they usually had to eliminate an existing one. To bring on a new product, a retailer would incur several costs, including the cost of removing the existing product to be eliminated from its inventory.

Innovation in the grocery business was, and remains, a risky process. The vast majority of new product introductions do not last longer than their initial order. In order to get its product on the retailer's shelves, the manufacturer must convince the retailer that its new product is going to be among that small minority of innovations that will succeed and be re-ordered.

Manufacturers can conduct test markets, and show the results to the retailers. However, even test marketing is no guarantee of success. The most spectacular new product failure in the grocery industry, "New Coke," was extensively test marketed before its release. Then there remains the problem of asymmetric information: the test market studies are done, and presented, by the manufacturer, who has an incentive to show the results in a manner most favorable to it.

Slotting Allowances as Incentive Signals

The classic article on asymmetric information was by Akerlof, who showed that if sellers have less information than buyers markets might not exist at all. [Akerlof 1970] This problem of asymmetric information was then studied by Spence, who introduced the idea of the incentive signal. [Spence 1974] A signal is an action that enables a party to a transaction to truthfully transmit information to the party on the other side of the transaction. To function as a signal, the action must be profitable to the firm (or individual) taking the action, while the action is not profitable to the firm (or individual) from which it is trying to distinguish itself.

Imagine that there are competing manufacturers, and competing retailers. Manufacturers engage in research and development to produce product innovations. These innovations are of two types: the first is a guaranteed "success," while the second is a "dud." Manufacturers can distinguish between the two after innovation but before introduction. Retailers cannot distinguish between successes and duds until after they place their initial order, and see consumer reactions. Retailers eventually make money on successes, but lose money on balance by adopting duds. Successes are re-ordered by the retailers, while duds are not. Manufacturers are assumed to make money (ignoring the sunk cost of R&D) even if the product is a dud. If the ratio of successes to duds is low, it might not be profitable for retailers to take on a new product if they cannot distinguish whether or not it will be a success or a dud, since the aggregate costs incurred from duds could exceed the aggregate benefits from successes.

A manufacturer that has a success on its hands can distinguish its product from those of the manufacturers of duds by offering to pay a slotting allowance. By offering an allowance the manufacturer is "putting its money where its mouth is," and is in effect telling the retailer that it is so confident that the product is a success that it is willing to pay the one time fee. If the product is a success, it will be able to earn back the slotting fee on re-ordered products. This would not be profitable for the manufacturer of a dud, since there will be no subsequent re-orders.

Whether or not a manufacturer is willing to pay a slotting fee therefore transmits valuable information to the retailer. The retailer is able to learn something that, absent the slotting allowances, only manufacturers would know.

This ability to transmit knowledge in turn affects the incentives of the manufacturer. Successes now become more valuable to the manufacturer, while duds become more expensive. They therefore have an increased incentive in their research and development to produce successes, rather than duds. In their marketing research, they therefore have an increased incentive to find out whether a new product is a success, or a dud.

Slotting Allowances as a Way of Allocating Risk and Resources

The prior section described a model in which manufacturers work on R&D projects with uncertain outcomes. Once the project was completed though, the manufacturer (but not the retailer) face no more uncertainty. In reality, market research has its limitations, and a manufacturer will not be able to determine with certainty how an innovation will fare in the marketplace once the R&D is finished. In offering a new product for sale, the manufacturer will face risks, as will those retailers who accept the new product and put it on their shelves.

As seen above, slotting allowances allow the costs of the innovation process, and with it the risks, to be shifted from retailers to manufacturers. By adjusting the size of the slotting fee, the allocation of risk between retailers and manufacturers is also adjusted.

Finally, slotting allowances can give retailers incentives to reallocate shelf space between different product categories. When the price of soybeans rises relative to the price of corn, this tells farmers to grow more soybeans and less corn. Similarly, when slotting fees for facial tissues rise relative to shoe polish, this tells grocers to devote more shelf space to tissues and less to shoe polish.

So, in theory, slotting allowances can serve as an important means of communication between manufacturers and retailers, serve to allocate risk, and give important information that allows retailers to reallocate shelf space between product categories. Economists generally tend to view such things as procompetitive.[1]

Complaints About Slotting Allowances

A variety of firms and commentators have complained about slotting allowances. They have coupled these complaints with demands that the antitrust enforcement agencies take action to make slotting allowances illegal and eliminate them from the marketplace.

Slotting allowances may be a relatively new phenomenon. However, the claims that they are anticompetitive and worthy of antitrust attention are not in themselves new. On closer examination, the arguments against slotting allowances are variations of older claims of anticompetitive problems. These claims were raised, and rejected a long time ago, though not before their earlier acceptance by the courts caused injury to competition.

Slotting Allowances Price Small Manufacturers Out of the Market

This is may be the most common source of complaints by industry participants against slotting payments. As slotting allowances have increased, so has the upfront cost to a manufacturer to obtain wide distribution. The argument is that small manufacturers do not have the financial resources to finance slotting payments, and therefore are not able to introduce new products.

This concern is a variant of the claim that capital is a barrier to entry. Capital as a barrier to entry has been discredited as a matter of antitrust concern for more than two decades.[2]

The basis of this argument is that there are all sorts of small manufacturers who are inventing new products that consumers would buy if only they could find them on store shelves. However, because these small manufacturers lack the internal financial resources to cover the cost of introducing these new products, consumers are being denied their benefits.

Unexplained though is why these manufacturers cannot seek outside financing. If this truly is a worthwhile product, then establishing a distribution system for it is a worthwhile investment. In the United States we have the most efficient capital markets in the world. There is no shortage of venture capitalists and venture capital funds, all seeking profitable investments, and willing to take risks to achieve superior returns. Why then are all these investors overlooking so many worthwhile investments?

In my 1991 article, I cited complaints made by Richard S. Worth, the creator of "Frookie cookies, in a1988 *Wall Street Journal* article [Gibson 1988] concerning his inability to obtain retail distribution for his product. Mr. Worth appeared on the ABC television news program *20/20* in November, 1995, again complaining about his inability to get retail distribution for his cookies. Also appearing on this program were David Ruiz, whose family makes tortillas, and Scott Galt, manufacturer of Georgia's Gourmet Barbeque Sauce. Mr. Ruiz complained that his family's product was driven off of store shelves by larger manufacturers who offered slotting payments. Mr. Galt also complained that he was unable to obtain distribution for his product because of his inability to pay slotting allowances.[3] In September 1999 testimony before the U.S. Senate Scott Garfield, Vice President of Lee's Ice Cream of Baltimore Maryland, and two other food retailers who testified *incognito*, also complained that they were unable to obtain retail distribution. [U.S. Senate 2000]

As mentioned above, all of these gentlemen face what is for them an uncomfortable fact: there is not enough room on grocery shelves for all the products that manufacturers want to sell to the public. If slotting allowances did not exist, this would still not imply that they would be able to obtain shelf space. Even if they did obtain shelf space, there would be another manufacturer out there that would also like its product to be on that same shelf, but was not able to. These manufacturers in turn would be around to complain about their inability to obtain distribution.

These gentlemen present no evidence that either retailers or competing manufacturers have colluded in any way to keep their products off grocers' shelves. Nor have they presented any evidence that any dominant retailer or dominant manufacturer has taken any action to keep it off the grocers' shelves. We do not know what products the two *incognito* witnesses produce. However, there is not to my knowledge any shortage of consumer choice in tortillas, barbeque sauces, ice cream, or cookies, nor any obvious monopoly problem for these products. Absent additional evidence, it is therefore difficult to see from their experiences what competitive harm has taken place, or why their inability to obtain the distribution that they desire is an antitrust problem.

Slotting Allowances Discourage Innovation

If we look at a competitive market, and we observe the price of the good in question go up, we know that at least one of three things has happened: a) demand for the good has increased, b) supply of the good has decreased, or c) the market has ceased to be competitive and output is being restricted in an anticompetitive manner. If we have the additional information that as the price went up, so did the quantity that was transacted, then we know for sure that demand has increased.

We can look at slotting allowances as being the price for innovation. In my earlier article, I noted that with the emergence of slotting allowances, the price of innovation had risen from zero to a positive number. What then happened to quantity? In 1987 and 1988, the number of new product innovations in the grocery industry exceeded 10,000, four times the number of new introductions a decade earlier [Gibson 1988, Mayer 1989]. What has happened since then? Hard data is hard to come by, but it appears that slotting allowances have, on average, increased over the last decade. As to quantity, according to New Product News, new product introductions in supermarkets, pharmacies, and health food stores were 22,572 in 1995 and 19,572 in 1996. According to Marketing Intelligence Service Ltd., new product introductions in these stores were

25,261 in 1997 and 25,181 in 1998.[4] So much for discouraging innovation: there could be as many as ten times as many new products brought to market than when slotting allowances did not for all practical purposes exist. I am still reminded of Yogi Berra's statement about a restaurant: "nobody goes there anymore, it's too crowded."

There is a limit to the number of items a store can carry. Shelf space is therefore a scarce resource, and one that is increasingly in demand. Would the world be a better place if this were not the case, and somehow sufficient shelf space could costly appear out of thin air in sufficient quantity to drive the level of slotting allowances to zero? The answer is obviously yes. Would innovation be higher in such a fantasy world? Again the answer is yes. Slotting allowances discourage innovation in the sense that innovation would be higher in this imaginary land. In the world in which we do live, where scarcity is a fact of life, it is a meaningless comparison.

The fact that slotting allowances are so high is a reflection of the scarcity of shelf space relative to the demand for it. Slotting allowances are the price mechanism that rations a scarce resource to those who are the most willing to pay for it. It is also the price signal that tells retailers to produce more shelf space. It is the scarcity that limits innovation, while the slotting allowance is just the consequence of that scarcity.

Setting the price of slotting allowances to zero through government fiat is not going to change that scarcity. On the contrary, it will exacerbate it. Milton Friedman is fond of pointing out that there is a lot that the economics profession does not know. However, the one thing that it does know is how to create a shortage of something: you put on price controls to keep the price below the market clearing level. If your goal is to encourage innovation, then putting a price control on it is not the way to go about it.

Slotting Allowances Raise Retail Prices

My comments in the subsection immediately above apply as well to the claim that slotting allowances cause retail prices to be higher than they otherwise would be. If scarcity of shelf space were not a fact of life, the world would be a better place, and the nation as a whole would be richer than it would be with the reality of scarcity. Once again though, this is a meaningless comparison.

The relevant comparison is between a world where manufacturers and retailers are free to negotiate slotting allowances, and a world where they are forbidden by government fiat from doing so. Certainly the long history of government price controls does not give one cause for optimism that the second world would be the better one.

Professors Bloom, Gundlach, and Cannon have completed a study that sampled the opinion of executives of both manufacturers and retailers. [Bloom, Gundlach and Cannon 2000] Among the questions asked was whether or not slotting allowances have raised retail prices. It is not clear however what was the relevant comparative that these executives had in mind when they answered the question.

Discrimination in Slotting Allowances Disadvantages Small Manufacturers and Retailers

Professor Gundlach [Gundlach 2000] has testified:

> Compared to their larger counterparts, small manufacturers and small retailers can be particularly disadvantaged by slotting fee practices. Small manufacturers often end up paying more for these fees compared to larger manufacturers who are able to better negotiate these fees and pay less. Larger manufacturers are also better positioned to absorb the cost of these fees and are known to use this ability as a basis for disadvantaging smaller rivals through bidding up the price of these fees. When accompanied by exclusive shelf-space arrangements, slotting fees by large manufacturers further disadvantage small manufacturers' ability to compete.

> Small retailers can also be disadvantaged by slotting fees. Small retailers often receive a smaller proportion of revenues from these fees than their larger counterparts who are in a better position to ask for and receive higher fees. The general trend toward retail consolidation in the grocery industry is likely to exacerbate this disparity and provide large retailers with greater influence to command an even more disproportionate amount of these fees.

It is generally accepted that the purpose of the antitrust laws is to promote competition for the benefit of consumers. This principle has unfortunately been ignored in the past to protect competitors rather than competition, and in particular to protect competitors from competition, to the detriment of consumers. Some of the most egregious examples of this have involved claims of price discrimination.

This sorry history has been well documented by antitrust scholars. Robert Bork devotes an entire chapter of his book [Bork 1978] to price discrimination, and it suffices to quote his introductory and concluding remarks:

> The attempt to counter the supposed threat to competition posed by price discrimination constitutes what is surely antitrust's least glorious hour. The instrument fashioned for the task was the Robinson-Patman Act, the misshapen progeny of intolerable draftsmanship coupled to wholly mistaken economic theory. One often hears of the baseball player who, although a weak hitter, was also a poor fielder. Robinson-Patman is a little like that. Although it does not prevent much price discrimination, at least it has stifled a great deal of competition.
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> There appears, then, to be no general case against price discrimination on consumer welfare grounds, and the better guess seems to be that, in general, price discrimination benefits consumers.

This attitude toward Robinson-Patman enforcement is not limited to adherents of Chicago School antitrust. Someone once commented that you could put all of the economists who support the act in a Volkswagen Beetle, and have room left over for a chauffer. For example, Professor Scherer writes in his text [Scherer 1980]

> The Robinson-Patman Act is an extremely imperfect instrument. It is questionable whether the circle of its beneficiaries extends much wider than the attorneys who earn sizeable fees interpreting its complex provisions. In many ways it conflicts with both the spirit and the letter of other antitrust laws It certainly has the potential of encouraging competitors to pull punches. . . . And there is surely much to criticize about a law that requires business decision makers regularly to consult their attorneys before making price moves.
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> The best hope, therefore, for a rational public policy toward price discrimination may lie in the higher courts' willingness (granted, with less than perfect consistency) to overturn Robinson-Patman Act interpretations patently inconsistent with competition, efficiency, or plain common sense.

Slotting allowances are part of a complex negotiation between a manufacturer and a retailer. It is the task of the manufacturer to convince a retailer that it is in the retailer's own economic interest to adopt the manufacturer's new product. While slotting allowances play a part in that, so do many other factors, such as the wholesale price, the retail price that can be charged, and the promotional efforts that will be made by the manufacturer, either directly or in cooperation with retailers. The decision of whether or not to adopt the product depends on how the retailer assesses the value of that product.

Each potential new product is different. To single out a single part of the total package, the slotting allowance, and compare it to that same part of the package for the new product of some other manufacturer, without taking into consideration the other parts of the two packages, is not a meaningful comparison.

I noted in the 1991 article that Procter & Gamble had a policy of not paying slotting allowances. From comments made in the aforementioned *20/20* program, this was still true in 1995. [Senate 2000] Suppose now that we were to compare a potential new product offered by Procter & Gamble to one being offered by a small manufacturer that has never before had a product in national distribution. Suppose further that to get on the store shelf, this small manufacturer must pay a slotting allowance, while the P&G product does not.

Is this discrimination? If you focus only on the slotting allowance, it is true that the small manufacturer has paid more than P&G. However, P&G is able to offer something that the small manufacturer did not and can not: the services of its rather formidable and experienced marketing organization. Therefore when you look at the total package that each firm offered, it is not possible to say which firm was "discriminated" against.

If we were now to compare large retailers and small retailers, we are once again faced with the problems of comparing apples to oranges. However, let us ignore this problem, and ask instead how the fact that a larger retailer receives higher slotting payments than a smaller retailer injures the smaller retailer. The only way by which the smaller retailer can be injured would be if the higher slotting payments received by the larger manufacturer cause the larger manufacturer to charge a lower retail price. Slotting allowances cannot simultaneously raise retail prices and lower them.

Large Manufacturers Use Slotting Allowances to Bid Up Shelf Space and Exclude Smaller Competitors

The idea that a manufacturer, or a cartel of manufacturers, can exclude smaller competitors by monopolizing shelf space is not a new one. It is actually a good decade older than the emergence of slotting allowances. In the late 1970s the Federal Trade Commission brought a complaint against the major breakfast cereal manufacturers, in *RE: Kellogg*. The industry was identified as operating in a concentrated market, earning high rates of return, and was lacking in political influence. Professor Richard

Schmalensee was hired by the Commission to devise an anticompetitive theory that could explain these facts, and so justify antitrust remedy.

He came up with a theory that these firms were a "shared monopoly." They were able to maintain this shared monopoly by producing too many brands of breakfast cereal. By so doing they saturated grocery store shelves, and left no room for any new entrants. [Schmalensee 1978]

The case was tried before an administrative law judge, who found for the respondents. The FTC staff then appealed the judge's decision to the entire Commission. The Commission decided unanimously in favor of the respondents.

The *Kellogg's* case demonstrates that slotting allowances are not necessary for antitrust enforcers to make a claim that a group of companies use control of shelf space to exclude rivals, though of course that claim was unsuccessful. Whether or not the introduction of slotting allowances would allow them to fare better is an open question.

Slotting Allowances Decrease Informational Advertising

Professor Gundlach has also testified [Senate 2000] that

> Consumers can receive less information as a result of slotting fees given manufacturers often pay their cost through tapping funds originally targeted for consumer directed marketing. Payment of these fees from these funds leaves fewer dollars available for consumer directed promotion that includes information. These effects are amplified for small business given their generally lower promotional budgets and access to financial resources.

Manufacturers and retailers have both a cooperative and a competitive relationship. It is in the interest of both to maximize the value of a particular product, that is, to maximize the "size of the pie" of profits that both can earn from it. Their relationship is then competitive when it comes to "cutting the pie," that is, dividing up the profits between them.[5]

Let us start by imagining a vertically integrated firm, one that does both the manufacturing and the distribution. Such a firm will spend funds on promoting its product to consumers until the marginal benefits to the firm of doing so just equal the marginal costs. Doing so maximizes the firms profits from its manufacturing and distribution.

Now imagine instead that manufacturing and distribution are done by independent firms. What is the optimal level of promotional expenditures for both firms? It is the same level of promotional expenditures that would be chosen by the vertically integrated firm. To spend any less would be to forgo the opportunity to increase the joint profits of the two firms, and hence the opportunity to increase the profits of both firms. Doing so would be against both firms best interests, since they would be "leaving money on the table."

Economic theory predicts that when individuals or firms are in a vertical relationship that they will act in such a way as to maximize their joint profit. This hypothesis has been successfully tested experimentally. In fact, it is the oldest tested hypothesis in experimental economics. [Fouraker and Siegel, 1963] It is therefore difficult to understand why retailers would choose to act against their own best interests by having manufacturers spend less then they otherwise would on consumer directed promotion.

Slotting Allowances As a Facilitating Practice

Mention should also be made of a paper by Professor Shaffer. [Shaffer 1991] His work is a highly stylized model of competition in the grocery industry. He finds in his model that "In providing a means for retailers to commit contractually to high prices, a manufacturer indirectly raises retailer profits by eliminating their incentive for aggressive downstream pricing. Although manufacturers would prefer lower retail prices and hence greater sales, the competition among themselves for the scarce shelf-space provides the incentive for such contracts."

Professor Sullivan finds little empirical support for the issues raised by Professor Shaffer: " Anticompetitive explanations for slotting allowances are refuted by the evidence. Shaffer's theory predicts that slotting allowances should have been accompanied by increases in retailer prices, retail profits, and manufacturer prices. None of these predictions is supported. [Sullivan 1997]

Professor Shaffer's model does not deal with such topics as uncertainty in the innovation process, and as such is not able to evaluate the procompetitive aspects of slotting allowances discussed above. He does however note them in his testimony in the FTC's hearing on global competition that dealt with slotting allowances. [Shaffer 1995.

Retailers are Charging Whatever the Market Will Bear

One of the complaints about slotting allowances is that retailers are charging more than the actual cost to them of introducing new products. That is not, in and of itself, a matter for antitrust concern. The courts long ago decided that it was not their job to determine particular outcomes or judge whether or not a given price was reasonable. The purpose of the antitrust laws is to protect the process of competition to determine economic outcomes, not to decide those outcomes in advance. Were retailers to collude to set the level of slotting allowances, then this is a matter for antitrust, even if the level that they choose is less than or equal to their cost. Absent some action to interfere with competition, the retailer is free to charge whatever price it chooses.

Summary

Arguments that slotting allowances limit competition are not always new. To a large extent they are variations of old concerns. These concerns may at one time have been accepted by some students of antitrust, but have nowadays are dismissed.

Furthermore, they are frequently contradictory. Those calling for the elimination of slotting allowances would have us believe that slotting allowances are bad because they raise retail prices, and so hurt consumers, and are bad because they lower retail prices, and so hurt small retailers. They would have us believe that slotting allowances are bad because they discourage innovation, and they are bad because they encourage large manufacturers to innovate too much.

Efforts to Ban Slotting Allowances

There have been a few cases which have tested the legality of slotting allowances. Antitrust attorney Robert Skitol notes two private Robinson-Patman suits that survived summary judgment and have written opinions holding that slotting allowances are subject to the Robinson-Patman Act. However, he notes that both cases settled before trial. He also notes that another case, in which a magazine distributor claims that his business was destroyed by the practice of larger rivals paying slotting fees. Said distributor filed suit against these rivals under Section 2 (c) of the Robinson-Patman Act, and was scheduled for trial in February of 2000. [Senate 2000]

The Bureau of Alcohol, Tobacco and Firearms (ATF) adopted regulations in 1995 which banned the use of slotting allowances in the distribution of alcoholic beverages. As noted above, there is an important distinction between protecting competition and protecting competitors. In its decision, the ATF adopted the latter approach. In the explanation for its decision, it notes comments made by FTC staff, and states[6]:

> Before responding to the particular FTC staff comments, AFT feels it is necessary to point out that the FAA [Federal Alcohol Administration] Act is concerned with the impact of a particular marketing practice on an individual retailer and not on the entire retail market in any particular locality (e.g., "relevant market"). The latter market focus is the concern of the antitrust laws enforced by the FTC and explains why the vertical restrain framework applied by the FTC is not relevant to an FAA Act analysis. Congress deemed the general antitrust laws insufficient to address the unique unfair trade practice problems in the alcoholic beverage industry. This is why the FAA Act itself does not contain the term competitive unlike the general antitrust laws: an absence acknowledged by the FTC staff. Instead, the Act focuses on the transactions between an industry member and "any retailer" or "any trade buyer."

A fuller analysis of the ATF decision is provided by Professors Gundlach and Bloom. [Gundlach and Bloom 1998]

The Ban on Payola

Payola is the undisclosed payment of money, or other inducements, in order to get a radio or television broadcaster to include material in the broadcaster's programming. Such payments were made a crime by Congress in 1960 when it amended the Communications Act.

In 1979 the Nobel Laureate economist Ronald H. Coase published an analysis of payola. [Coase 1979] His goal was to understand why such payments came to be made, assess whether they were beneficial or harmful, and therefore to evaluate whether or not the 1960 amendments were desirable. The fascinating story of the practice of payola described in his paper has important parallels and lessons for those who would examine whether or not slotting allowances are beneficial or harmful.[7]

Payola, though it was not originally called that, existed as early as the mid-19th Century, when music publishers paid musicians, singers, and band leaders to perform their music. It was a mechanism by which they competed with one another. It was also a form of competition that they attempted to restrict. According to author Isaac Goldberg [Goldberg 1930] music publishers banded together and agreed to give up the practice of buying singers to plug their works. However, the agreement to restrict competition failed because "Publishers began to make secret arrangements with headliners; the duplicity was discovered, and the lid blew off."

In October, 1916 *Variety* reported that the head of a 5-and-10-cent store syndicate was attempting to bring together the music publishers "to eliminate the existing evils of the business, the principal one being the payment system," which was the term at the time for what later came to be called payola. Under the plan, music publishers would be forbidden to pay performers to popularize their compositions. Charges of violations would be judged by a committee of "outside men," and if found guilty, the syndicate of retailers would refuse to sell that publishers product. The *Variety* report noted that such a system was needed, because "the 'payment system' is slowly but surely tearing large chunks into [the publishers'] reserve bank rolls."

This effort failed, but was replaced by an effort organized by the business manager of *Variety*. In May, 1917 he formed the Music Publishers' Protective Association (MPPA). *Variety* reported the formation of the MPPA under the headline "Song Payments End This Week." That same issue of *Variety* contained an advertisement for the MPPA, which stated its goals:

> The primary and main object of this association just formed shall be to promote and foster clean and free competition among music publishers by

> eradicating the evil custom of paying tribute or gratuities to singers or musicians employed in theatres, cabarets and other places to induce them to sing or render music, which custom has worked to the detriment of the theatre management and the public through the rendition of music, not because of its merits, but because those singing or rendering it received gratuities in some form for so doing. Such practices have tended to discourage and retard the work of music writers, whose labors have not had a free field for competition.

What was the effect of the formation of the MPPA? Author Hazel Meyer wrote "Within twenty-four hours, the overt payola to vaudeville performers stopped. Within another twenty-four hours, payola was underground."[8]

When collusion to prevent payola failed, the MPPA turned to what is historically been an effective way of policing a cartel: have the government do it for them. In 1933 the MPPA asked the newly formed National Recovery Administration adopt a code of conduct that would be legally binding on the industry. The head of the MPPA testified in July, 1934 that the MPPA

> . . . was organized 17 years ago in an endeavor to put a stop to . . . unfair trade practices which are in the nature of bribes paid to orchestra leaders, radio performers and to other artists who appear in public, to induce those artists to perform the copyrighted composition of one publisher in competition or in opposition to their selecting . . . the composition of another publisher. . . . These practices run into enormous sums of money annually and are extremely costly to the industry. We have tried as an association to put a stop to them. We cannot very readily do that because we cannot control the whole industry, but only members of the Association, and that is one of the reasons we have felt the need of the code because by having it, we would be able to control these activities and practices in connection with the entire industry. . . . [The code] is protective . . . of the small publisher who does not have the money, does not have the capital, to go out and buy this talent.

After the National Recovery Administration Act was declared unconstitutional, the MPPA next went to the Federal Trade Commission, and sought to have it adopt a Trade Practices Rule for the music publishing industry. The proposed code was practically taken verbatim from the NRA's Code of Fair Competition for the Music Publishing Industry. The FTC rejected this rule in 1938.

In the 1950s, payments by music publishers switched from the performers to the disk jockeys. Critics of payola claimed that it was responsible for the degradation of music, with "whining guitarists, musical notes put to a switchblade beat, obscene lyrics about hugging, squeezing and rocking all night long," rather than the work of composers such as Cole Porter, Richard Rogers, or Irving Berlin.

Professor Coase concluded:

> To sell music on a large scale it is necessary that people hear it. Payola is one way of inducing people to play it so that it can be heard. From a business point of view, the ban on payola is therefore simply a restraint on one kind of promotional or advertising expense. Before World War II, when it was the music publishers who wished to see payola abolished, their aim was to eliminate one dimension of competition and thereby to increase their total profits. What they wanted was similar to the more general bans on advertising which have been instituted by various professional associations. After World War II, when opposition to payola came from those segments of the popular music industry which were hurt by the rise of the new music and the associated development of record companies, the aim of the business interests which sought to curb payola seems to have been not so much to secure a general benefit for the industry as to hobble their competitors.
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> What has been described as happening after the ban on payola is the normal result of a situation in which no price is exacted for the receipt of a valuable service. Indeed, in the early days, what we now call payola was termed the "payment system," or as economists would say, the pricing system. When a pricing system is not used and something of value is provided for nothing, people are willing to incur costs up to its worth in order to secure the benefits of that service. One reason, among others, for pricing a service is to avoid this unnecessary use of resources. Normally we consider such pricing as natural without considering the advantages it brings. If locating stores on a particular street or in a particular section of a town enables those stores to achieve greater sales, we expect that the rent charged will reflect this. In the same way, if the playing of a record by a radio station increases the sales of that record, it is both natural and desirable that there should be a charge for this. If this is not done by the station and payola is not allowed, it is inevitable that more resources will be employed in the production and distribution of records, without any gain to consumers, with the result that the real income of the community will tend to

> decline. In addition, the prohibition of payola *may* result in worse record programs, will tend to lessen competition, and will involve additional expenditures for regulation. . . .
>
> It is not enough to outlaw payments simply because they can be described as "improper." Some attempt should be made to discover why such payments are made and what would in fact happen in the world as it exists if they were made illegal.

Conclusion

In my earlier paper, I concluded that slotting allowances could be nothing more than a natural marketplace reaction to an increase in innovation by manufacturers. As such, they are a form of competition, and competition is what the antitrust laws (at least most of them) were intended to encourage. My application of standard antitrust analysis to claims that slotting allowances could restrict competition caused me to have considerable doubts that the practice constituted any threat to competition or to consumer welfare. My review of industry developments, what has been written since then, and what case law there is has not caused me to change my opinion.

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Endnotes

[1] Other authors have also noted the procompetitive benefits of slotting allowances. [Toto 1990], [Chu 1992], [Messinger and Chu 1995], [Laviviere and Padmanabhan 1997] [Sullivan 1997]
[2] Bork [1978] notes "Capital requirements exist and certainly inhibit entry – just as talent requirements for playing professional football exist and inhibit entry. Neither barrier is in any sense artificial or the proper subject of special concern for antitrust policy."
[3] A transcript of the segment in question is included in [U.S. Senate, 1999] at 399.
[4] These figures were given by Professor Gundlach in his written response to post-hearing questions [U.S. Senate, 1999] at 435.
[5] I am indebted to Robert Steiner for his insights on this.
[6] Federal Register 20404, Vol. 60, No. 80, Wednesday, April 26, 1995.
[7] I am indebted to M. Bruce Johnson for bringing the Coase paper to my attention.
[8] [Meyer 1958] at 162.